

**REPORT OF AUDIT OF THE
DEPARTMENT OF VETERANS AFFAIRS
CONSOLIDATED FINANCIAL STATEMENTS
FOR FISCAL YEARS 1999 AND 1998**

**REPORT NO. 99.00006.46
DATE: March 14, 2000**

**DEPARTMENT OF VETERANS AFFAIRS
Office of Inspector General
Washington, DC 20420**


**Memorandum to the Assistant Secretary
for Financial Management (004)**

**Report of Audit of the Department of Veterans Affairs Consolidated
Financial Statements for Fiscal Years 1999 and 1998**

1. The Office of Inspector General (OIG) conducted an audit of the Department of Veterans Affairs (VA) Consolidated Financial Statements for the fiscal years (FYs) ended September 30, 1999 and 1998. This report contains our audit opinion and our assessments of VA's internal control and compliance with laws and regulations.
2. The objective of a financial statement audit is to determine whether the financial statements taken as a whole are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation.
3. Our audit was made in accordance with generally accepted auditing standards, the **Government Auditing Standards** issued by the Comptroller General of the United States, and the Office of Management and Budget's Bulletin No. 98-08, as amended. The audit includes obtaining an understanding of the internal control over financial reporting, and testing and evaluating the design and operating effectiveness of the internal control. Due to the inherent limitations in any internal control, there is a risk of error or fraud may occur and not be detected.
4. Our audit opinion provides an unqualified opinion on the Department's Consolidated Financial Statements for FYs 1999 and 1998. This represents a major milestone in improving financial management and reporting in VA and provides sound baseline information for the future Office of Financial Management staff and the Chief Financial Officer staffs of the Veterans Health Administration and the Veterans Benefits Administration made a significant effort to make this possible.
5. Our Report on Internal Control discusses three material weaknesses concerning (i) VA-wide information system security controls, (ii) Housing Credit Assistance (HCA) program accounting, and (iii) fund balance with Treasury reconciliations. The Department made significant improvement to address previously reported information system security controls and HCA program accounting issues. We encourage the Department to continue their efforts and to complete correction of the remaining open information security and HCA recommendations and the new recommendations concerning fund balance with Treasury reconciliations. These internal control weaknesses expose VA to significant risks and vulnerabilities. The Department reported the information systems security controls and the HCA program accounting issues as material weaknesses in their Federal Managers' Financial Integrity Act (FMFIA) reports for FYs 1999 and 1998. In this report we reaffirm our prior recommendations and have additional recommendations addressing these weaknesses and the reportable conditions. We believe these three issues should be considered for inclusion as material weaknesses in the Department's FMFIA reporting.

6. Our Report on Compliance with Laws and Regulations discusses the Department's non-compliance with Federal Financial Management Improvement Act (FFMIA) requirements concerning HCA program financial management information systems, information system security, and cost accounting standards. Except for these noncompliances, the report concludes that for the items tested, VA complied with those laws and regulations materially affecting the financial statements. We also continued to identify noncompliance with one law that while not material to the financial statements, warrants disclosure: the requirement for charging interest and administrative costs on compensation and pension accounts receivable.

7. We will follow up on these issues and evaluate implementation actions during the audit of VA's FY 2000 Consolidated Financial Statements.

A handwritten signature in black ink, reading "Michael Slachta, Jr." with a stylized flourish at the end.

MICHAEL SLACHTA, JR.
Assistant Inspector General
for Auditing

**OFFICE OF INSPECTOR GENERAL'S REPORT
ON THE DEPARTMENT OF VETERANS AFFAIRS
CONSOLIDATED FINANCIAL STATEMENTS**

**To the Secretary
Department Of Veterans Affairs**

This report presents our opinion on the Consolidated Financial Statements of the Department of Veterans Affairs (VA). This report also presents our determinations from our review of the Department's internal controls and our review of compliance with certain laws and regulations.

OPINION ON FINANCIAL STATEMENTS

We have audited the accompanying Consolidated Balance Sheet of the Department of Veterans Affairs as of September 30, 1999 and 1998, and the related Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, and the Combined Statement of Financing for the fiscal years then ended. These financial statements are the responsibility of VA's management. Our responsibility is to express an opinion based on our audit.

Scope

We conducted our audit in accordance with generally accepted auditing standards, the **Government Auditing Standards** issued by the Comptroller General of the United States; and the Office of Management and Budget's (OMB) Bulletin No. 98-08, **Audit Requirements for Federal Financial Statements**, and amendments. These standards require that we plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion. Moreover, in accordance with these standards we reviewed VA's internal control structure and its compliance with laws and regulations.

Opinion

In our report dated March 10, 1999, we qualified our opinion on the Department's FY 1998 Consolidated Financial Statements due to our inability to satisfy ourselves as to the recorded balances of certain Housing Credit Assistance (HCA) program related accounts. The Department has subsequently restated the statements, and we have been able to satisfy ourselves as to these recorded balances. Accordingly, our present opinion on the FY 1998 Consolidated Financial Statements, as presented herein, is different from that expressed in our previous report.

In our opinion, the accompanying Consolidated Financial Statements present fairly, in all material respects, the financial position of the Department as of September 30, 1999 and 1998, and the related items in the Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, the Combined Statement of Budgetary Resources, and the Combined Statement of Financing in conformity with generally accepted accounting standards and OMB guidance as described in Note 1 of VA's financial statements.

Consistency of Other Information

Our audit was conducted for the purpose of expressing an opinion on VA's Consolidated Financial Statements taken as a whole. VA's draft Accountability Report included an overview of VA and supplemental financial and management information containing a wide range of data, most of which are not directly related to the Consolidated Financial Statements. The information presented in the draft Accountability Report and the supplemental financial and management information has not been subjected to the auditing procedures applied in the audit of the VA's Consolidated Financial Statements and accordingly, we express no opinion on this information. We reviewed the draft Accountability Report to assess whether the information and the manner of its presentation is materially inconsistent with the information, and the manner of its presentation, appearing in the Consolidated Financial Statements. Based on our limited work, we found no material inconsistencies with the financial statements.

REPORT ON INTERNAL CONTROL

We conducted our audit in accordance with the **Government Auditing Standards** issued by the Comptroller General of the United States; and the Office of Management and Budget's (OMB) Bulletin No. 98-08, **Audit Requirements for Federal Financial Statements**, and amendments. In planning and performing our audit of VA's Consolidated Financial Statements as of and for the fiscal years ended September 30, 1999 and 1998, we considered VA's internal control structure in order to determine our auditing procedures necessary for expressing our opinion on the financial statements. In evaluating the reliability of financial information we obtained an understanding of the design of internal controls, determined whether they have been placed in operation, assessed control risk, and performed tests of VA's internal controls. However, our evaluation was not made to provide assurance on the overall internal control structure. Consequently, we do not provide an opinion on internal controls.

Because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the internal control structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or the effectiveness of the design, and operation of policies and procedures may deteriorate.

In addition, with respect to internal controls related to performance measures reported in the Department's draft Accountability Report, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin 98-08. Our procedures were not designed to provide assurance on internal control over reported performance measures and accordingly, we do not provide an opinion on such controls.

With respect to Required Supplementary Stewardship Information (RSSI), we performed a review to determine the reasonableness of data presented. Our procedures were not designed to provide assurance on internal control over RSSI and accordingly, we do not provide an opinion on such controls.

Management's Responsibility For Establishing And Maintaining Internal Control Structure

VA's management is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, management makes estimates and judgments assessing the expected benefits and related costs of internal control structure policies and procedures. The objective of an internal control structure is to provide management with reasonable, but not absolute, assurance that (i) assets are safeguarded against loss from unauthorized use or dis-

position, (ii) transactions are executed in accordance with management's authorization, and (iii) transactions are recorded properly to permit the preparation of the financial statements in accordance with generally accepted accounting standards and OMB guidance.

Definition Of Reportable Conditions

We noted certain matters involving the internal control structure and its operation that we consider reportable conditions under standards established by the American Institute of Certified Public Accountants and OMB's audit requirements. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements and reported performance measurement information.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Conclusion

We concluded that three matters involving the internal control structure and its operation were weaknesses that could materially affect VA's Consolidated Financial Statements: information systems security, Housing Credit Assistance (HCA) program accounting, and fund balance with Treasury reconciliations. The Department continued to report information systems security and relevant HCA program accounting areas as material weaknesses in their Federal Managers' Financial Integrity Act (FMFIA) report for FY 1999. In our opinion, these internal control weaknesses expose VA to significant risks and vulnerabilities.

1. **Information Systems Security Controls.** VA's program and financial data continue to be vulnerable to error or fraud because of Departmentwide weaknesses in automated data processing (ADP) general controls. We previously reported this condition in our FY 1997 and 1998 audit reports and made recommendations for VA to implement a comprehensive security program that would improve these controls. The Department reported information system security controls as a material weakness in its FMFIA report for FY 1998. During FY 1999, VA proposed and took a number of corrective actions, particularly at VA Central Office, that could result in an effective comprehensive security program and eventually strengthen other general controls. The initiatives are beginning to be implemented but have not yet had the time to permeate the entire Department. However, a number of obstacles exist that could hinder or undermine VA's efforts to implement a comprehensive security program. The obstacles include significant organizational weaknesses in information security programs at the Veterans Health Administration (VHA) and the Veterans Benefits Administration (VBA), as well as the need to commit the resources needed to implement an effective information security program.
2. **Housing Credit Assistance Program Accounting.** The Department substantially completed corrective actions on conditions we reported on in prior years concerning serious weaknesses in direct loan portfolio, loan sales accounting, and Credit Reform subsidy model issues. Following the end of FY 1999, VA also began processing HCA program expenditures directly through VA's core financial system to resolve another FMFIA non-compliance issue. However, a number of material weaknesses still exist that impede

timely completion of financial statements and reduce the use and value of internal financial reports for management control and program monitoring of its direct loans and related foreclosed properties. The Department's HCA program general ledger system does not interface with VA's core financial system and still is not compliant with Federal financial systems requirements.

3. **Fund Balance With Treasury Reconciliations.** Corrective actions were underway during FY 1999 to improve reporting and reconciling of fund balances with Treasury; however, weaknesses still exist that impair the completeness and efficiency of the reconciliations. The Austin Finance Service Center's (FSC) reconciliations were incomplete. The reconciliation process verified that Treasury transactions were recorded in VA's general ledger, but did not verify whether items recorded in VA's general ledger agreed with Treasury records. Additionally, documentation was deficient. Incomplete reconciliations were caused to a great extent by the cumbersome, labor intensive process involved, and weaknesses in the existing accounting system and the Treasury reporting and reconciliation processes. Internal VA cash account transactions continued to be reported on the Statement of Transactions, SF-224, provided to Treasury. New transaction codes were implemented to ensure cash entries were correctly recorded, but controls did not exist to ensure the new codes were used. Additionally, station level reconciliations intended to facilitate resolution of differences were not fully implemented during FY 1999.

To assist Department managers in improving operations and financial reporting, we are also issuing management letters addressing internal control weaknesses in information systems security; HCA program accounting; medical facility accounts receivable; property accounting; payroll and timekeeping; veterans benefits accounting; life insurance accounting; and expenditures and payables.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

We conducted our audit in accordance with the **Government Auditing Standards** issued by the Comptroller General of the United States; and the Office of Management and Budget's (OMB) Bulletin No. 98-08, **Audit Requirements for Federal Financial Statements**, and amendments. Compliance with laws and regulations applicable to VA is the responsibility of VA's management. As part of obtaining reasonable assurance as to whether the financial statements were free of material misstatement, we performed tests of VA's compliance with certain provisions of laws and regulations. However, our objective was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Under Public Law 104-208, "Federal Financial Management Improvement Act (FFMIA) of 1996," we are required to report whether the agency's financial management systems substantially comply with the Federal financial management system requirements, Federal accounting standards, and United States Standard General Ledger (U.S. SGL) at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance for FFMIA in OMB Bulletin No. 98-08. As part of our audit, we also reviewed management's process for evaluating and reporting on internal control and accounting systems as required by the Federal Managers' Financial Integrity Act (FMFIA), and compared the Department's most recent FMFIA reporting with the evaluation we conducted of VA's internal control system.

Conclusion

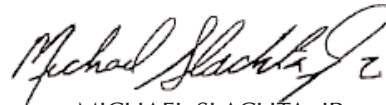
The results of our tests for FY 1999 indicate that, for the items tested, VA complied with those provisions of laws and regulations which could have a material effect on the financial statements, except for the following FFMIA requirements.

1. VA's HCA systems were not yet fully compliant with FFMIA requirements that Federal systems comply with Federal financial system requirements published by the Joint Financial Management Improvement Program. VA's HCA general ledger and subsidiary program systems did not interface with VA's core financial system and also did not have processes in place for reconciling general ledger and subsidiary foreclosed property data, and for providing financial information that could be used in monitoring HCA programs. Additionally, the HCA systems did not provide timely data necessary for preparing VA's Consolidated Financial Statements.
2. With the exception of the Austin Automation Center, the Department was noncompliant VA-wide with FFMIA information system security requirements.
3. VA was noncompliant with respect to requirements that systems be able to accumulate and report the costs of their activities on a regular basis. With respect to the cost accounting system requirements, the Department was able to develop and allocate costs on a reasonable basis in preparing the Consolidated Statement of Net Cost. However, full implementation of activity level cost accounting systems was in process but not completed during FY 1999. VBA had implemented a cost accounting system during FY 1999, while the National Cemetery Administration (NCA) was testing a system during FY 1999. VHA designated and approved its managerial cost accounting system in November 1998. Department officials informed us they expect all systems to be fully compliant in FY 2000.

Additionally, VA was noncompliant with provisions of Public Law 96-466 and Title 38 United States Code Section 5315, "Interest and Administrative Costs" that, while not material to the Consolidated Financial Statements, warrants disclosure. We have reported each year since our report of the Audit of VA's Consolidated Financial Statements for FY 1992, that VA was not in compliance with the requirements that interest and administrative costs shall be charged on any amount owed to the United States for an indebtedness resulting from a person's participation in a benefits program administered by the Secretary, other than a loan, loan guaranty, or loan-insurance program. Since FY 1992, VA has not taken collection action on over \$152.6 million in interest and administrative costs due the Department. VA should comply with the law for charging interest and administrative costs on benefits program indebtedness.

With respect to transactions not tested, nothing came to our attention that caused us to believe that VA had not complied, in all material respects, with those provisions.

This report is intended for the information of the management of VA, OMB, and Congress. However, this report is a matter of public record and its distribution is not limited.

A handwritten signature in black ink, appearing to read "Michael Slachta, Jr.", with a stylized flourish at the end.

MICHAEL SLACHTA, JR.
Assistant Inspector General
for Auditing

March 10, 2000

REPORTABLE CONDITIONS

1. Information System Security Controls

VA's program and financial data continue to be vulnerable to error or fraud because of Departmentwide weaknesses in automated data processing (ADP) general controls. We previously reported this condition in our fiscal year (FY) 1997 and 1998 audit reports and made recommendations for VA to implement a comprehensive security program that would improve these controls. The Department reported information system security controls as a material weakness in its Federal Managers' Financial Integrity Act (FMFIA) reports for FYs 1998 and 1999.

During FY 1999, VA proposed and took a number of corrective actions, particularly at VA Central Office, that could result in an effective comprehensive security program and eventually strengthen other general controls. VA has structured its initiatives to reflect generally accepted information security practices represented in publications and guidance disseminated by the General Accounting Office (GAO), the Office of Management and Budget (OMB), and the National Institute of Standards and Technology (NIST). At this time, these initiatives are beginning to be implemented but have not had the time to permeate the entire Department.

We also concluded that a number of obstacles exist that could hinder or undermine VA's efforts to implement a comprehensive security program. The obstacles include significant organizational weaknesses in information security programs at the Veterans Health Administration (VHA) and the Veterans Benefits Administration (VBA), as well as a lack of commitment from administration, program, and facility managers.

In addition to reaffirming our recommendations from previous years, we have added a new recommendation. This year we recommend VA strengthen its revised password policy. We also suggested that the Principal Deputy Assistant Secretary for Information and Technology take specific actions to implement, and then to verify the successful implementation of a revised minimum password policy by December 31, 2000.

Significant ADP General Control Weaknesses Continue

From September 1999 through January 2000, we conducted tests at VA and VBA central offices in Washington, DC; VHA's Medical Information Security Service (MISS) in Martinsburg, WV; and VBA data processing centers in Hines, IL and Philadelphia, PA. In addition, we conducted tests at VBA Regional Offices in Chicago, IL, Cleveland, OH, and St. Petersburg, FL; and VHA's Stars and Stripes Health Care Network [Veteran Integrated Service Network (VISN) Number 4]; and the Pittsburgh Health Care Center, in Pittsburgh, PA. In addition to our work, GAO staff conducted tests at the New Mexico Health Care System in Albuquerque, NM and the Dallas Medical Center in Dallas, TX.

Our audit tests continue to demonstrate wide spread weaknesses in each of the ADP general controls: entity-wide security program planning and management, access controls, application software development, systems software, segregation of duties, and service continuity. Often, the needed improvements were well known within the security community, such as installing and implementing patches (corrections in software), employing more secure configurations, and making use of more secure management procedures.

- ❑ Access controls and monitoring were ineffective at VBA. Penetration tests at VBA demonstrated that weaknesses allowed us to obtain privileged access from outside and inside VBA to significant computing resources without being detected. This access was

obtained using relatively unsophisticated methods including guessing account names and passwords, and exploiting known configuration weaknesses. These weaknesses could have been mitigated or prevented by stronger passwords, installing and implementing patches, better configurations, and use of more secure management practices.

- ❑ Significant weaknesses in ADP general controls also continued within VHA. For example, at one facility we determined that 3,860 users inappropriately had the ability to obtain one of the password files, and that 90 accounts remained active despite the fact that the owners had not signed on in more than a year. We also concluded that the Information Security Officer (ISO) was not adequately monitoring automated activities.

VA's Information Security Program Initiatives

VA developed its Information Security Program and began implementing initiatives late in FY 1999 and early FY 2000. We believe these initiatives could contribute significantly to a comprehensive security program that is well integrated into VA's organization. These initiatives include:

- ❑ An enterprise-wide assessment of information security risk and the preparation of an enterprise risk management plan. A contract for the initial assessments was awarded in December 1999.
- ❑ A Department incident response capability to provide the combined rules, roles, procedures, and tools for security incident response. The contract for this initiative was awarded in November 1999.
- ❑ Development of certification criteria and training curricula for Department ISOs.

In addition, VA is in the process of developing indicators to measure the progress it is making towards; 1) a mature information security management program, as well as 2) the effectiveness of its efforts to improve other general controls.

Obstacles To Implementing An Effective Information Security Program

VA's efforts to implement a comprehensive security program to improve ADP general controls may be hindered by ineffective organization and oversight at VBA and VHA. Security programs at VA's administrations were fragmented, lacked authority, and contained conflicting interests.

- ❑ Weaknesses existed in VBA's information security program organization. The fragmentation of security responsibilities at VBA central office was a significant barrier to a coordinated security program as well as a barrier to the effectiveness of our efforts to gather information about their program. Security responsibilities were delegated across operations divisions that did not share significant information.
- ❑ VBA's security program was not well understood by its staff members. One staff member incorrectly believed he no longer had security responsibilities that were delegated to his position in a May 1997 memorandum.
- ❑ Weaknesses existed in VHA's information security program. The location of MISS within VHA's organization structure provided insufficient authority to effectively integrate security practices into VHA. MISS was located two steps below and within the VHA's Chief Information Officer's (CIO) organization. MISS staff could not provide us updates on the progress of VISN security programs or programs securing VHA's national gate-

ways that interface networks. Further, we did not find any involvement by security professionals with the initiative that developed the Computerized Patient Record System.

- ❑ The mission of MISS to provide operational support to program, VISN, and facility Directors conflicted with their mission to oversee information security programs at these same locations. Separating the operational support and security functions would strengthen security.

VA's efforts to implement a comprehensive security program were also hindered by a lack of effective oversight by its administrations. VBA central office staffs had not verified, and MISS staffs had limited ability to verify that corrective actions were taken effectively at respective facilities. For example, MISS staff had not verified that reported actions were effectively implemented at one of the facilities we visited. Our test results indicated that the corrective actions reported by facility staffs to MISS were not effective. Without improved oversight VA will not be able to accurately assess the status and effectiveness of actions taken to improve information security.

VA's efforts to implement a comprehensive information security program will fail without significant commitments from program and facility Directors to dedicate necessary resources.

- ❑ The need to improve security practices by facility Directors is demonstrated by the practice of assigning information security responsibilities as collateral duties to individuals who do not possess adequate technical knowledge. Often the assigned staffs have limited time for security responsibilities. For example, one ISO (who did not possess adequate technical knowledge) was able to spend only 2 hours each day overseeing three medical campuses. These campuses included a 590-bed medical center treating neuropsychiatric, substance abuse, and intermediate care veterans; a 446-bed acute and intermediate care facility; as well as a 240-bed nursing home care unit. Research programs included aging, alcoholism, computer science, and immunology. As a result, we noted significant information security weaknesses at this three-campus facility.
- ❑ The practice of appointing individuals with limited technical knowledge and little time for security responsibilities may also contribute to a high turn over rate within these positions. Twenty-six percent of VHA's ISOs were newly appointed during the fiscal year. This turn over rate may cause VA's efforts to improve the knowledge of and time available for ISOs to be unsuccessful.
- ❑ Program and facility Directors demonstrated the need to strengthen their commitment to improving information security by implementing existing VA password policy for their own accounts. VA Directive 6210 prohibited English words, required passwords to be at least six characters long, and required passwords to be changed at least every 180 days. For example, one facility Director used a password that was an English word only five characters long; in addition, another program Director's passwords never expired. We also questioned managers' understanding of the need for improved security because we generally observed a lack of significant security improvements during our follow-up audits.

Conclusion

VA's program and financial data continue to be vulnerable to error or fraud because of Departmentwide weaknesses in ADP general controls. We continue to see significant weaknesses in physical and logical access controls, segregation of duties, systems software, appli-

cation software development, and contingency planning. These weaknesses present an immediate risk to VA information resources. Efforts underway to implement a comprehensive security program that will improve ADP general controls need to be integrated and subjected to effective oversight.

We have also suggested¹ that VA's Principal Deputy Assistant Secretary for Information and Technology put forth considerable effort during FY 2000 to ensure that more complex passwords are implemented throughout the Department. This effort should help focus VA's efforts to overcome the obstacles it faces and to improve an access control often used to compromise program and financial information. We believe this effort can succeed by:

- ☐ Directly notifying all VA employees via email of the new minimum requirements periodically during the year. In addition, VA contractors and other users should be notified periodically.
- ☐ Periodically reminding VA employees in logon announcements to use the more complex revised passwords.
- ☐ Training VA employees how to manage and remember more complex passwords.
- ☐ Auditing password composition quarterly of a significant sample of VA systems to identify passwords that do not meet the 8-character, alphabetic, numeric, and "special" character requirements. The persons responsible for those accounts should be notified in writing and provided additional training. This responsibility should include accounts that are used by computers or computer processes.

Recommendation No. 1

We reaffirm the recommendations a through f below that we made in our FY 1997 and 1998 audit reports and provide a new recommendation g that VA enhance information security by:

- a. Modifying current policies and procedures to provide more explicit direction to criteria for the organizational level being addressed to establish comprehensive standards and minimum information security safeguards.
- b. Strengthening the oversight and monitoring of information security activities.
- c. Strengthening information system controls that limit and monitor access to operating system and application software as well as data.
- d. Ensuring that a comprehensive contingency program incorporates regular backups and continuous recovery testing and improvement.
- e. Strengthening safeguards that restrict physical access to computers and reduce environmental vulnerabilities.
- f. Providing computer operations and security staffs with training about the specific technologies they are responsible for monitoring.
- g. Revising provision 1b of **VA's User Account and Password Management Policy** to specify that passwords must be at least eight characters in length and that each password

¹Management Letter-VA's Minimum Password Configuration Policy, Report No. 99.00003.33

must include at least 1) one alphabetic, 2) one numeric, and 3) one “special” character (e.g., \$, %, &).

2. Housing Credit Assistance Program Accounting

During FY 1999 the Department substantially corrected conditions we reported on in prior years concerning internal control weaknesses in direct loan accounting, loan sales accounting, and Credit Reform subsidy reporting. However, the following material internal control weaknesses existed that impede timely completion of financial statements and reduce the effectiveness of safeguards over HCA program resources.

- ☐ The HCA General Ledger System (GLS) is not compliant with Federal financial systems requirements.
- ☐ Detail foreclosed property information in HCA program systems was not periodically reconciled to the HCA control accounts.
- ☐ About \$30 million of refunded loans processed at VA Regional Offices was not recorded in the HCA GLS.
- ☐ Program transactions were not recorded timely in HCA general ledger accounts.
- ☐ The liability for loan guarantees and related Credit Reform subsidy re-estimates could not be prepared timely because of HCA program and financial system weaknesses.
- ☐ Weaknesses in oversight of the contractor managing VA's \$1.8 billion direct loan portfolio increased the Government's vulnerability to losses.

At the end of FY 1999, the HCA program loan guaranty liability totaled \$5.8 billion, direct loans receivable and foreclosed properties awaiting sale totaled about \$3.6 billion, and program subsidy costs totaled \$890 million for the year.

During the audit, VBA had a number of organization and system changes underway to address the internal control weaknesses noted. Management officials informed us their goal is to complete all corrective actions by the end of FY 2000. Timely implementation of the organization and system changes underway is important. Accurate, reliable, and timely financial reports are essential to enable managers to carry out their fiduciary and stewardship responsibilities to VA beneficiaries and the public. Without them, the HCA financial statements will continue to be prepared untimely and are vulnerable to error. Additionally, program assets and resources may not be efficiently used or adequately safeguarded.

Noncompliance With Federal Financial System Requirements

The HCA GLS is not compliant with Federal financial systems requirements. VA first identified a need for improving HCA systems in its 1986 FMFIA report. Starting with the FY 1996 VA Consolidated Financial Statement audit, the OIG has reported serious internal control weaknesses in the HCA accounting process for each successive year. The Department continued to report loan guaranty financial modernization as a material weakness in its FMFIA report for FY 1999. In 1999, they reported that the loan guaranty system lacked up-to-date interfaces between manual and automated components. They further reported that 70 percent of loan guaranty monies flow through accounts that were standard general ledger (SGL) compliant at the end of FY 1999.

One area of noncompliance involved the lack of summary control accounts for significant items such as loans receivable and foreclosed property. For example, the GLS had no loans receivable or foreclosed property control accounts although their balances totaled about \$1.9 billion and \$1.3 billion, respectively. Numerous subaccounts had to be manually added together for seven different funds to compile the control account total. The control accounts would help improve internal control by providing a baseline for comparison when doing reconciliations, and would also facilitate financial statement preparation and reporting.

As management has reported, VA's GLS does not interface with VA's core financial system in a number of areas. During FY 1999, loans sales accounting was interfaced with VA's core financial system. Starting October 1, 1999, HCA began processing payments previously processed through its Automated Voucher Audit Payment System directly into VA's core financial management system. However, other transactions for the direct loan and guaranteed loan financing accounts, as well as transactions for several other HCA funds and systems, were not yet integrated with VA's core financial system. VBA officials stated their goal is to fully switch to VA's core financial system by the end of FY 2000.

Reconciliation Of Foreclosed Property Detail Information In Program Systems To General Ledger Control Accounts

The acquisition and claim amounts recorded in HCA program systems were not reconciled to GLS control accounts to verify the completeness and accuracy of the records, or to ensure that internal controls adequately safeguarded these assets. VA had about 18,000 foreclosed properties with claim and acquisition costs of about \$1.3 billion for which it either had marketable title or for which foreclosure proceedings were in process at the end of FY 1999.

The Joint Financial Management Improvement Programs (JFMIP) Core Financial System Requirements establish that Federal financial management systems have a general ledger analysis and reconciliation process to ensure that amounts posted to general ledger control accounts agree with detailed subsidiary accounts, and in reconciling system balances with financial information contained in reports from Treasury and other agencies. To support the general ledger analysis and reconciliation process, financial systems must:

- ☐ Report a comparison between amounts in other components of the core financial system and the related control accounts in the SGL and annotate out-of-balance accounts on the report.
- ☐ Provide control accounts in the general ledger and other systems, such as property.
- ☐ Provide the capability to correct out-of-balance conditions discovered during the reconciliation process, and maintain an audit trail of any such corrections.

We were not able to completely reconcile the detail in the program system subsidiary files to the HCA GLS. We did however establish that the total amount reported is reasonable through the use of other analytical procedures. The analysis and tests made included 1) reconstructing the capitalized costs of foreclosed properties shown in the HCA program systems and comparing to HCA GLS amounts, 2) comparing reconstructed capitalization amounts with historical data, and comparing with amounts capitalized for foreclosed properties sold during FY 1999, 3) analysis of the elapsed time properties have been held since foreclosure or since title was obtained, and 4) other analytical reviews to assess whether properties should be included in the inventory.

Several voids in existing HCA program systems and the HCA GLS make reconciliation cumbersome and difficult. First, a summary control account is needed in the GLS to show the total of foreclosed properties on hand at the end of each accounting period. A multitude of sub-accounts must be added to compile the total instead of the GLS system doing it. Second, an automated method is needed to extract acquisition and claim cost accounting data from the program systems at the end of each accounting period for foreclosed property on-hand.

Our analysis identified a number of conditions indicating errors in the HCA program system data or general ledger data, or possible internal control weaknesses in managing foreclosed properties. The conditions included:

- ❑ One-hundred-eighteen properties with costs of \$9.6 million with foreclosure dates from FY 1996 all the way back to FY 1981.
- ❑ One property on hand for which VA had obtained marketable title (Title Status 2) during FY 1990 and another during FY 1996.
- ❑ Another approximate 500 properties for which VA's property management system included no cost information.

VBA field stations perform monthly reconciliations between the HCA program systems and the station GLS to ensure individual transactions are recorded. HCA program officials also require that field stations do an annual verification of data in their Property Management System. The last verification was in February 1999. When the applicable general ledger control accounts are established, complete reconciliations should be done at least quarterly by HCA program and financial management staff, and the reconciliations should include comparisons between the program detail subsidiary records and general ledger accounts to verify both the number and dollar amount of properties on hand.

Refunded Loans Processed At VA Regional Offices Need To Be Recorded Timely Into The General Ledger Accounts

HCA staff used a manual process to identify about \$29.7 million of VA refunded loans (i.e., guaranteed loans VA acquired, thus making the loans direct VA loans) being processed at VA Regional Offices. The amounts were not in the HCA GLS at the end of FY 1999. To identify the amounts for inclusion in VA's financial statements, VBA instructed all field stations to identify and manually report the loans not yet in the HCA GLS. HCA staff attributed the problem to difficulty in obtaining needed documentation from the original lenders, and receipt of incomplete or erroneous information that precluded them from recording the transactions into VA's systems. HCA program and financial management need to develop and implement system changes that capture and track refunded loan data to ensure all refunded loans are recorded timely in VA's program systems and general ledger. HCA program staff stated that their Loan Service and Claims (LCS) system implemented in September 1999 would eventually be able to track the refunded loan data.

Lack Of Timely Data To Support Credit Reform Accounting Requirements

Considerable corrective action was taken and improvement realized during FY 1999 to (i) refine the credit subsidy model, (ii) calculate the subsidy rates, and (iii) determine the loan guaranty liability. Using a contractor, the Department revised the credit subsidy model to identify and estimate the liability for the guaranty on direct loans VA had sold, and reconstructed various historical records. Because of the many changes that took place during the year, and

the related adjustments and restatements necessary to the loan guaranty portion of the financial statements, completion of final financial statements was delayed.

In addition, delays in completing the HCA financial statements occurred and are likely to continue to occur because of dated automated accounting systems which lack important controls and financial reporting capability. Significant manual processing and adjustments necessary to prepare the financial statements also result in an increased risk of errors. Dated automated accounting systems inhibit the ability to identify errors and anomalies in accounting data. VBA needs to continue efforts underway to migrate all loan guaranty accounting to VA's core financial system so that the financial statements can be system generated.

Efforts to reconcile the loan guaranty liability revealed numerous differences between amounts originally recorded. Although the net adjustment was not material to the financial statements, significant errors found in amounts originally recorded reduce the usefulness of historical data for program analyses. Examples include; errors in the timing and/or amount of some subsidy estimates and re-estimates, interest income and expense, amortization; and the timing and completeness of recorded cash flows. In addition, wide variations between years and funds for gross margin on foreclosed property sold, increase the risk that some transactions were not recorded appropriately. Although the incidence of these problems has been significantly reduced in recent years, uncorrected errors from the early and mid 1990's could continue to impact the loan guaranty liability balance.

Additional refinement is also needed of data used in the subsidy model. Subsidy calculator "warnings" that occur as a result of negative costs input to the subsidy model should be resolved. To further refine the loan guaranty liability estimate, HCA staff should do additional research and adjustment to further minimize upward and downward re-estimates, and to make comparative data more meaningful for program analysis.

Oversight Of VA's Direct Loan Portfolio

In a separate report, Evaluation of Loan Guaranty Service's Quality Control System, the VA OIG reported serious weaknesses in VA's oversight of its portfolio loans that were being managed by a contractor. As of September 30, 1999, the portfolio included about 29,000 direct loans with an unpaid principal balance valued at \$1.9 billion. About 3,200 of these loans, with an unpaid principal balance valued at \$209 million, were in serious default (defined by VA as loans 5 or more months delinquent) and for which the borrowers would need to pay \$36 million to clear their outstanding delinquencies. The review revealed a number of contractor performance deficiencies such as: the contractor had not actively serviced many of the loans as required by the contract, the contractor had not timely referred seriously defaulted loans for foreclosure, and finally, the contractor had not routinely monitored about 24 percent of the bankruptcy cases tested.

Strong oversight to ensure effective management and servicing of the direct loan portfolio is needed to minimize the risk of loss on loans that go into default. The vulnerability to such losses has increased as a result of an increase in the number of refunded loans in the portfolio during the last several years.

VBA program staff initiated corrective action based on the report recommendations to improve direct loan portfolio servicing by establishing an oversight review team to do periodic reviews and audits. The first review is in process. Management expects it to be complete by approximately the end of March or April 2000.

Conclusion

HCA financial statement reporting will continue to be a high-risk area vulnerable to error until corrective actions are complete and HCA program and financial systems comply with Federal financial system requirements.

Recommendation No. 2

We reaffirm recommendation a made in our FY 1997 and 1998 audit reports, and add new recommendations b through d:

- a. Replace or modify the current multiple program-oriented systems with an integrated financial accounting system that interfaces with VA's core financial system and meets Federal financial accounting requirements.
- b. Develop and implement procedures to ensure that complete reconciliations are performed between program subsidiary records and general ledger control accounts.
- c. Develop and implement general ledger control accounts for financial statement items such as loans receivable, foreclosed property, and any other accounts for which general ledger control accounts should be maintained.
- d. Continue system changes underway to migrate all loan guaranty accounting to VA's core financial system.
- e. Continue analysis and correction of baseline historical data used in the subsidy model to further refine the loan guaranty liability estimate.

3. Fund Balance With Treasury Reconciliations

Corrective actions were underway during FY 1999 to improve reporting and reconciling of Treasury fund balances; however, weaknesses still exist that impair the completeness and efficiency of the reconciliations. Reconciliations performed at VA's Finance Service Center (FSC) located in Austin, TX. were incomplete. The reconciliation process verified that Treasury transactions were recorded in VA's general ledger, but did not verify whether items recorded in VA's general ledger agreed with Treasury records. Additionally, documentation was deficient.

Incomplete reconciliations were caused to a great extent by the cumbersome, labor intensive process involved, and weaknesses in the existing accounting system and Treasury reporting and reconciliation processes. Internal VA cash account transactions continued to be reported on the Statement of Transactions, SF-224, provided to Treasury. New transaction codes were implemented to ensure cash entries were correctly recorded, but controls did not exist to ensure the new codes were used. Additionally, station level reconciliations intended to facilitate resolution of differences were not fully implemented during FY 1999.

VA's Financial Management System (FMS) is the primary accounting system for Treasury Agency Location Code (ALC) 1200. For this ALC, in FY 1999 VA reported SF-224 disbursements of approximately \$8.8 billion and receipts of approximately \$1.1 billion. The Financial Reports Section at the Austin FSC prepares the SF-224s, performs reconciling activities, and monitors FMS general ledger cash transactions for ALC 1200.

Concerning Treasury reconciliations for ALC 1200, we reported in a management letter based on our FY 1998 Consolidated Financial Statement audit that 1) the Statement of Transactions, SF-224, provided to Treasury included numerous collection or disbursement transactions that

do not pass through Treasury, 2) VA's Financial Management System (FMS) did not have controls to ensure all accounting entries for internal VA cash account transactions requiring multiple entries were input simultaneously, and 3) reconciliations were incomplete.

Unreconciled Differences

Reconciliations for both receipts and disbursements were incomplete. Our analysis showed approximately \$5.8 million more in total FY 1999 disbursements on Treasury reports than the net disbursements shown in VA's general ledger for the same accounts. Unresolved disbursement differences at the end of FY 1999 totaled about \$1.6 million, and depository differences at the end of FY's 1998 and 1999 that had been unresolved for from 1 month to 2 years amounted to \$2 million and \$1 million, respectively.

VA financial management staff attributed unresolved deposit differences to timing differences between when transactions were recorded by VA and when the transactions cleared Treasury. While most deposits clear after about one month, differences older than one month generally remained unresolved. VA had not reconciled the amount of deposit differences shown on Treasury's Statement of Difference. Internal VA reports were used to match VA and Treasury depository data, but the specific items composing the depository Statement of Difference amounts were not identified. VA needs to develop and implement a process to identify items making up the depository differences. These prior month differences need to be resolved because the number of months with depository differences will continue to grow if not adequately addressed.

Financial management staff attributed disbursement differences to 1) timing differences, 2) intra-VA transactions where accounting staff failed to record the second or third part of a multi-part transaction, and 3) transactions where staff input the incorrect month of the original transaction. We were unable to verify the content of the disbursement differences because copies of the reconciliations were not kept as of the conclusion of each month's reconciliation efforts. The absence of these records prevented us from determining the extent reconciliations were performed completely and timely during the year, and made verification of prior month amounts reported in Section II of the SF-224s impossible.

In addition, internal VA transactions were not always eliminated from amounts reported to Treasury and when adjustments for internal VA transactions were made, they were not entirely accurate or documented. Internal VA transactions are transactions that do not involve a Treasury disbursement or a change in appropriation, such as a transfer between stations within the same appropriation. During FY 1999, VA did not have current, written procedures to instruct employees on SF-224 reporting requirements, documentation, and procedures. Written procedures were being prepared in FY 2000. Furthermore, supervisory review of the SF-224s was not documented. Supervisors should document their review of supporting evidence, computations, and adjustments.

In addition, an adjustment decreasing VA's Treasury Fund balance by about \$18 million was made to an expiring 1994 appropriation in June 1999 to resolve differences with Treasury. VA management attributed the differences to VA's previous reporting practices; however, the differences began accruing after reporting practices had been changed and VA had been unable to identify the exact appropriations and transactions causing the differences. Timely resolution of differences is critical because resolution becomes more difficult, if not impossible, as time passes.

Causes Of Reconciliation Problems

The difficulty in doing complete reconciliations at the Austin FSC was caused to a great extent by the cumbersome, labor intensive process involved, and weaknesses in the existing accounting system and Treasury reporting and reconciliation processes. The process is inefficient considering the large volume of transactions involved. We believe several changes could be made that would help reduce the volume and magnitude of unreconciled items that are required to be resolved each month.

The SF-224 reports prepared from FMS and submitted to Treasury for ALC 1200 are based on general ledger transaction activity rather than cash receipts and disbursements journals. As a result, a number of manual processes must be accomplished to adjust the FMS computer generated SF-224 in order to 1) take out internal VA transactions that should not be on the Statement of Transactions, and 2) adjust for timing differences between when transactions are recorded at VA and when the transactions clear through the Treasury account.

FMS presently adds the net monthly activity of 10 general ledger accounts to compute receipt and disbursement amounts on a computer generated SF-224. The weakness in this process is that the general ledger accounts include transactions that should not be reported to Treasury. Examples of these transactions are transfers between stations within the same appropriation, and offsetting and expensing of convenience checks. VA's internal control system lacks controls to ensure that internal transactions do not increase or decrease cash accounts.

VA planned to eliminate the affects of internal transactions by instituting controls to ensure an equal debit and credit to Treasury fund balance general ledger accounts was included. New transaction codes were added by VA. However, VA was unable to eliminate the old transaction codes that permitted internal transactions to result in a net increase or decrease being reported to Treasury.

In August 1999, VA developed a prototype station level report to identify internal VA transactions incorrectly reported to Treasury as disbursements and collections. Most of these transactions pertain to VHA field stations. The station level report was sent to field stations in September 1999 with a request to research and provide written responses on the internal transactions. VA plans for this to be a monthly process. During the first 2 months of FY 2000, many stations had not provided responses to the reconciliation report. The success of this station level report to aid in correcting internal transactions is dependent on all stations providing complete and accurate responses. Adding criteria to the VHA Financial Indicator Report to measure each stations performance in clearing unresolved items would increase the priority given to resolving these transactions.

In addition to implementing the station level reconciliations between the Austin FSC and VA field stations, the number of differences needing to be researched and resolved would be significantly reduced by modifying and adding specific VA SGL cash accounts so that the general ledger accounts mimic cash receipt and cash disbursement journals. Presently, some general ledger accounts used in FMS are not defined in VA's SGL and transactions that should not be reported to Treasury are permitted in the Fund Balance With Treasury, account series 10XX,

content. The following changes would help reduce the volume of non-SF-224 transactions reported to Treasury, thereby reducing the number of differences needing to be researched and resolved:

- ☐ Include every general ledger account used in FMS. There are 15 accounts in FMS that are permitted in the United States SGL, but are not defined in VA's SGL. VA's SGL should include these account numbers, their full titles, a general description of the uses of the account, and examples of debits and credits permitted in the account.
- ☐ Design the accounts to mimic cash receipt and cash disbursement journals. This would increase the accuracy and usefulness of the FMS computer generated SF-224, and reduce the number of adjustments required. Currently the computer generated FMS SF-224 must be manually adjusted to eliminate internal VA transactions. If the content of VA's SGL accounts were required to be strictly either Treasury or non-Treasury reporting transactions, then the computer generated SF-224 would only include those transactions that should be reported to Treasury.
- ☐ Computations should be revised to separate transactions into the following categories:
 - ☐ Cash disbursements from Treasury
 - ☐ Cash receipts deposited to Treasury
 - ☐ Transfers between funds and between stations
 - ☐ Transfers between funds within a station
 - ☐ Intergovernmental receipts
 - ☐ Intergovernmental disbursements
- ☐ Additional accounts should be added to the VA general ledger to specifically identify transactions that should not be reported to Treasury on the SF-224's. VA's SGL should provide separate accounts in the Other Cash 1190 category that are not forwarded to the FMS computer generated SF-224 for internal transactions such as:
 - ☐ Transfers between stations that are the same fund
 - ☐ Transfers within a station that are in the same fund
- ☐ VA should determine the feasibility of modifying or eliminating transactions that unnecessarily record multiple entries to cash accounts, such as the multiple transactions that must be recorded for items such as convenience checks which involve offsetting debits and credits to cash to complete a transaction.

Conclusion

Treasury reconciliations are a significant part of VA's internal control structure. Complete reconciliations are needed to ensure that VA and Treasury fund balances are accurately recorded and agree with each other. The reconciliations are also a compensating control that can assist an activity in identifying incorrect, improper, or fraudulent transactions. Compensating controls are particularly important in VA because we found and reported material ADP internal control weaknesses in the audit of VA's Consolidated Financial Statements.² Additionally, unreconciled items affect the accuracy and usefulness of internal management reports, and could materially affect station level financial statement reporting.

²Report of Audit of the Department of Veterans Affairs Consolidated Financial Statements for Fiscal Year 1998, Report No. 9AF.G10.062, dated March 10, 1999.

Recommendation No. 3

We recommend that the Assistant Secretary for Management:

a. Direct the Office of Financial Management to take the following actions to improve the Treasury reconciliation process:

- 1) Continue efforts to stop reporting internal transactions that do not involve appropriation transfers on the SF-224 and eliminate transaction codes that allow internal transactions to not include both a debit and a credit to cash.
- 2) Modify the VA SGL so that it defines all general ledger accounts used in VA's FMS and differentiates cash transactions not-reportable to Treasury, and coordinate the changes to VA's SGL with Treasury's Financial Standards and Reporting Division.
- 3) Develop written procedures for identifying and resolving all transactions making up the deposit and disbursement difference on the Treasury Statement of Differences.
- 4) Develop policies and procedures on reporting and reconciliation procedures, including supervisory reviews and documentation retention.
- 5) Develop and implement a system edit to prevent one-sided transactions.

b. Coordinate with the Under Secretary for Health and the VHA Chief Financial Officer to ensure that the following additional actions are taken to improve the Treasury reconciliation process:

- 1) Add resolution/clearance of internal VA cash transactions and disbursement and deposit differences as a performance measure on the VHA Financial Indicator report.
- 2) Develop and implement controls or edits to prevent field stations from entering only one part of a multi-part transaction into the accounting system.
- 3) Provide VHA staff instructions for entering accounting transactions into the accounting system in the correct month.

DETAILS ON COMPLIANCE WITH LAWS AND REGULATIONS**1. Public Law 104-208, Federal Financial Management Improvement Act (FFMIA) Of 1996**

The results of our tests for FY 1999 indicate that, for the items tested, VA complied with those provisions of laws and regulations which could have a material effect on the financial statements, except for the following FFMIA requirements.

HCA Federal Financial System Requirements

VA's HCA systems were not fully compliant with FFMIA requirements that Federal systems comply with Federal financial system requirements established by the Joint Financial Management Improvement Program. VA's HCA general ledger and subsidiary program systems did not interface with VA's core financial system and also did not have processes in place for reconciling general ledger and subsidiary foreclosed property data, and for providing financial information that could be used in monitoring HCA programs. Additionally, the HCA systems did not provide timely data necessary for preparing VA's Consolidated Financial Statements.

The Department continued to report loan guaranty financial modernization as a material weakness in its Federal Managers' Financial Integrity Act (FMFIA) report for FY 1999. They reported that the loan guaranty system lacked up-to-date interfaces in a number of areas. They further reported that 70 percent of loan guaranty monies flow through accounts that were standard general ledger (SGL) compliant at the end of FY 1999. Additionally, during FY 1999, loans sales accounting was interfaced with VA's core financial system and starting October 1, 1999, HCA began processing payments previously processed through its Automated Voucher Audit Payment System directly into VA's core financial management system. For other HCA funds and systems not yet integrated with VA's core financial system at the end of FY 1999, VBA officials stated their goal is to fully switch to VA's core financial system by the end of FY 2000.

We discussed the material weakness and make recommendations concerning VA's HCA systems in the Report on Internal Control Structure starting on page 118.

Information Security Requirements

VA was not compliant with the FFMIA requirements that security over financial information be provided in accordance with OMB Circular A-130. We discussed the material weakness and make recommendations concerning VA's information system security controls in the Report on Internal Control Structure starting on page 118.

Managerial Cost Accounting Requirements

Although improvements have been made, VA remains in noncompliance with the Statement of Financial Accounting Standard No. 4, **Managerial Cost Accounting Concepts** and Standards for the Federal Government provisions that require that systems accumulate cost data at the activity level. The Department was able; however, to accumulate and allocate costs to the 10 lines of business defined in the Statement of Net Cost on a reasonable basis in preparing the FY 1999 statement.

Since we first reported this issue in our audit of the Department's FY 1998 Consolidated Financial Statements, each of the three VA administrations has made accelerated corrections to attempt to comply with the standard. VBA has fully implemented the Activity Based Cost (ABC) system for providing their cost accounting information. The National Cemetery Administration (NCA) has also selected ABC for their cost system, but were still in pilot testing during FY 1999. NCA expects to implement ABC in FY 2000. VHA has designated the Decision Support System (DSS) as its managerial cost accounting system, but had not fully implemented the system throughout VHA. In addition, VHA was revising the system in FY 2000 to comply with full costing by including Headquarters, pension, and other retirement costs to the activity levels. VHA expects full compliance by FY 2001.

2. Public Law 96-466 And Title 38 United States Code (U.S.C.) Section 5315, "Interest And Administrative Costs"

We have reported each year since our report of the Audit of VA's Consolidated Financial Statements for FY 1992, that VA was not in compliance with Public Law 96-466 (the Veterans Rehabilitation and Education Amendments of 1980) and Title 38 U.S.C. Section 5315. Public Law 96-466 and Title 38 prescribe that interest and administrative costs shall be charged on any amount owed to the United States for an indebtedness resulting from a person's participation in a benefits program administered by the Secretary other than a loan, loan guaranty, or loan-insurance program. VA does not charge interest and administrative costs on compensation and pension accounts receivable balances. The balance for compensation and pension

accounts receivable totaled about \$490 million at the end of FY 1999. More than 56 percent (\$276 million) were over 2 years old. The total interest and administrative costs applicable to FY 1999 were over \$20 million. Since 1992, VA has not taken collection action on over \$152.6 million in interest and administrative costs due the Department.

In a July 1992 decision, the former VA Deputy Secretary decided that VA would not charge interest on compensation and pension debts. We disagreed with the Deputy Secretary's decision. Congress passed the law with the intent of charging interest and penalties on benefit debts similar to charges levied on other debts owed the Federal government. Rather than continuing the nonconformance, VA should comply, or work with Congress to change Public Law 96-466 if it believes that the law is not appropriate.

Chief Financial Officer Comments

Department of Veterans Affairs

Memorandum

Date: March 14, 2000
From: Assistant Secretary for Financial Management (004)
Subj: *Report of Audit of the VA's Consolidated Financial Statements for Fiscal Year 1999*
To: Inspector General (50)

1. Please convey my sincerest appreciation to everyone on your staff who worked so diligently on this year's audit of our financial statements. Certainly, we are very pleased with the overall outcome of the audit. We commend the efforts of your staff, especially Mr. John Jonson, to maintain a balance between cooperation and independence throughout this effort.
2. We will be sharing the results of the audit with senior officials in the Veterans Health Administration and Veterans Benefits Administrations as well as with other interested VA staff and program managers. The officials responsible for correcting the three material weaknesses—ADP Security, Housing Credit Assistance, and Treasury Reconciliation—will develop action plans, which we will forward to your office within 45 days from receipt of your final audit opinion.
3. Again, thank you for all the work that brought us to this successful conclusion. Please feel free to contact me at 273-5589 if you have any questions.

/original signed/
 Edward A. Powell, Jr.